DOW THEORY LETTERS INC.

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April 27, DJIA 922.19, PTI 816, A-D ratio -10.79
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THIS WEEK'S QUOTE: The bear market since 1966 is starting to make believers of the Wall Street professionals. I've been warning subscribers that nobody "beats" a bear market, but there are plenty of men who will be fated to learn that lesson the hard way. The clipping at right is from an article in the April 29, New York Times.

THE MARKET: It may come as a shock to most people, but there are only two things stocks can do. They can go up or down, and they can move on expanding or contracting volume. Actually, many dyed-in-the-wool market technicians insist that volume is merely a function of price. By this they mean that if a stock continues to rise it will ultimately attract a following (increasing volume), and if a stock continues to decline it will eventually lose its following (low volume). Thus these technicians (specifically point & figure chartists) do not even concern themselves with volume. They are interested in only one thing — whether a stock is rallying or declining.

Although I have always considered myself a market "technician," I must plead guilty to being interested in a good deal more than

Was A.T.&T. miffed at its bank advisers for their subpar performance? Not at all.

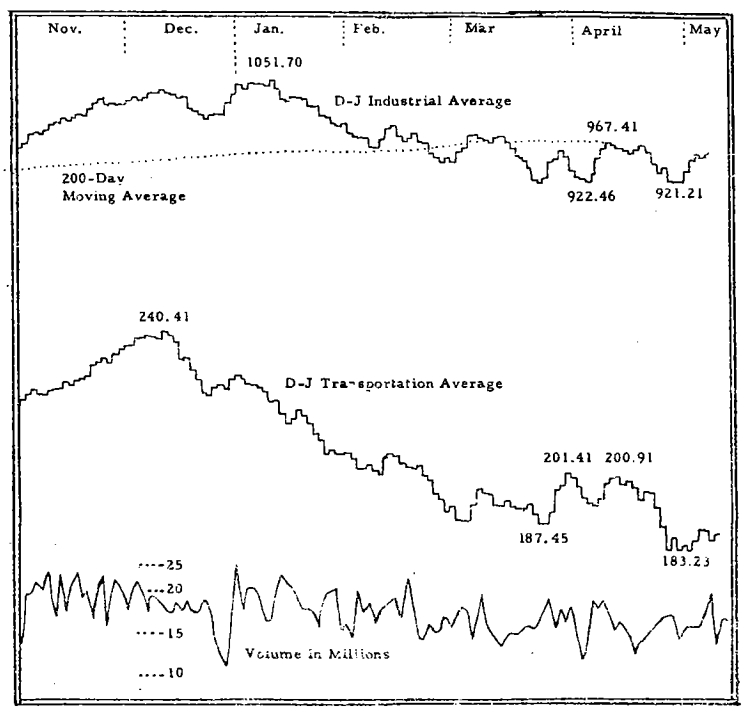
"We are satisfied that we are doing as well as other large pools of capital," said John F. Thompson, A.T.&T.'s director of pension-fund administration.

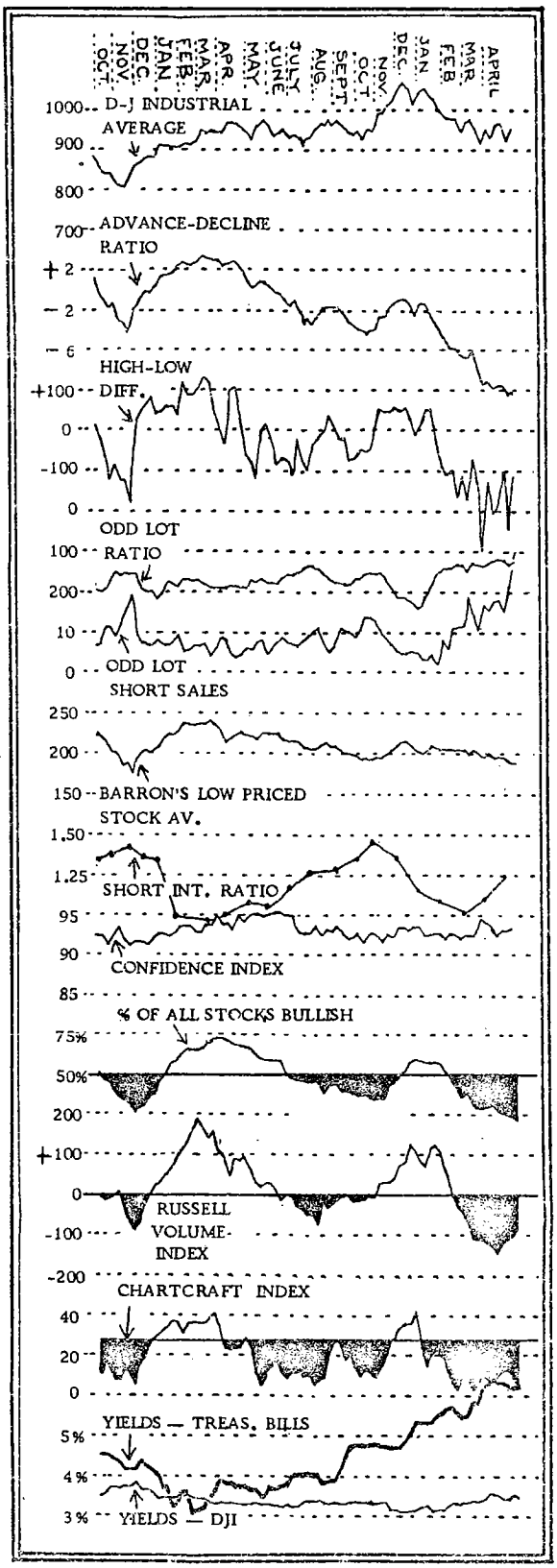
"Though it is defeatist not to try, because of A.T.&T.'s large pool of capital, I think it is unrealistic to expect to outperform the averages," Mr. Thompson added.

Several years ago Mr. Thompson's comment might have been greeted with snorts of ridicule about stodgy Ma Bell and unimaginative bank investment officers. After all, why else should A.T.&T. hire investment counselors unless it was to beat the averages? But no more.

"In 1968 everyone was trying to do 25 per cent better than the Standard & Poor's average," Mr. Ellis of Greenwich Research Associates noted. "In 1969 it was 15 per cent. In 1971 they were happy to rise and fall with the Standard & Poor's average. Now everyone is just hoping not to do substantially worse than anyone else."

Some of this sudden humility is probably related to the malaise that is currently gripping the stock market.





price in the market. In the last analysis, I agree with the great Dow Theorist, Robert Rhea, who believed that everything is reflected in price (the Averages) but who also felt that not a man alive possessed the talent or ability to be able to "read" the story that the Averages are telling to perfection. Lacking the gift of infallibility in reading the price charts, I have spent most of my adult life studying everything I could get my hands on which might aid me in my market interpretation (as can be seen, for example, by last Letter's treatise on Elliot Wave Principles).

Visitors often comment, "Russell, don't you get tired of reading all 'that stuff' and aren't you bored with trying to make sense out of the Wall Street picture?" My answer is, "Yes, I get tired, but no, it never loses its fascination." It's like working on a puzzle which offers no final solution. Like life, there is no final "answer" on Wall Street. You only (hopefully) get better at it.

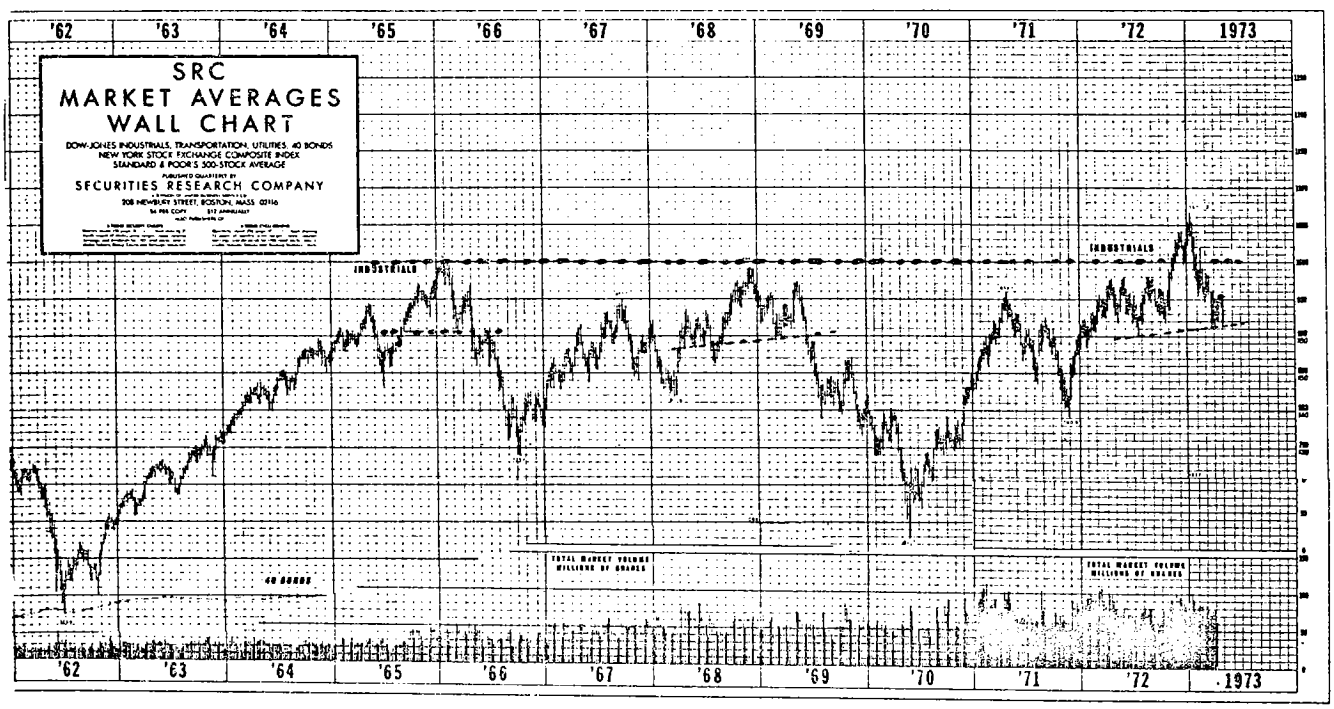
For the past ten months we have been offered the spectacle of a collapse in the general market, while the Dow Industrials bounce repeatedly down to, and then away from, the 910-920 level. The record of the various "attacks" on the 910-920 area is certainly a fascinating one. On July 20, 1972, the Dow struck a low of 910.43. A good rally ensued, then a decline, and on October 16, 1972, the Dow dropped to 921.66.

An explosive new rally took the Dow to an all-time high of 1051.70 on January 11, 1973, when lo, a decline toppled the Dow on March 23, 1973, to 922.71. Another little rally, and on April 5 the Dow skidded to a close of 922.46. Next, a rise to 967.41 on April 11, and then a plunge to the May 1 low of 921.21.

That makes five distinct passes at the 910-920 level for the Dow, all within a period of ten months! Much of this is shown on the page 1 chart, and all I can say is that one must have respect for the resiliency of the Dow. For despite collapses in the A-D ratio, Transports, the Amex, most over-the-counter issues, the venerable Dow Industrials have resisted like a desperate mountain climber who hangs by his fingernails to the edge of Mt. Everest.

I have stated repeatedly that the July, 1971, Dow low of 910.45 is the critical point on the downside. Each of the previously mentioned declines represented an attack on that 910.45 level, and on each assault the Dow has held. It is my opinion (this being a primary bear market) that in due time the 910.45 level will be smashed. Until then, it appears to me that the current "head-and-shoulders" top in the Dow will be extended. The next section will go into more detail on the long-range "toppy" picture which I believe is still in the process of forming (regardless of short-term rallies which could spring up from the current oversold area).

PERSPECTIVE: Here is a weekly (high-low) chart of the Dow Industrials covering the period of 1962 to date (chart courtesy of Securities Research, 208 Newbury St., Boston, MA 02116). The chart depicts the three advances of the Dow Industrials into the 900-1000 area. Each of these advances ended with the formation of a major top, although the latest (1972-73) has yet to be proved. The first assault on the 900-1000 area built a classic "head-and-shoulders" pattern (see chart). I have drawn the support for that top formation at the 905 level (dashed line). This support was penetrated during May, 1966, resulting in the major Dow decline to 744.32.



The second advance took the Dow to the late-1968 peak of 985.21, just 10 points below the 1966 high of 995.15. Again a classic head-and-shoulders top was formed. In June, 1969, the support at 900 was smashed, and again the Dow tumbled, this time to a June, 1970, low of 631.16.

From the 1970 low, the Dow mounted its third drive on the highs. On January 11, 1973, the Dow recorded an all-time peak of 1051.70. Note that the 1973 high was 51 points above the "1000 barrier" (shown by the long dashed line). Undoubtedly, this "extra 51 points" reflected Wall Street enthusiasm at the impending end of the Vietnam War. But even as the fighting sloughed off, the roaring fires of inflation set informed investors to unloading huge quantities of stock (the "peace market" gave large holders a perfect market to unload in). With the arrival of the pathetic economic Phase III, the market top was completed. The Dow headed down with a vengeance.

So again we see the formation of a head-and-shoulders top, Dow support at 900, and a Wall Street fraternity which is talking bravely about a major bottom being formed above the 900 level. As seen on the Value-line chart which was included in the last mailing, an unbelievable amount of damage has already occurred among the majority of issues on the NYSE. The single overriding question is — will the Dow crumble and add its own impressive weight to the wreckage of shares which litter the NYSE? Or will good fortune finally shine...

My view is that the current top is the largest of the three since 1966, and that in due time the Dow will follow the rest of the market down to what can only (charitably) be termed "undervaluation." The big technical break, as I have pointed out repeatedly, will occur if and when the Dow cracks the 1972 low of 910.45. It has been said that "the market always does what it is supposed to — but never when." With this in mind, it is entirely possible that we could have another push upwards to more fully form the right shoulder of the current formation. But my studies continue to suggest that ultimately the bear will have its way. The signal for the next major victory of the bear over the Dow Industrials will be a cracking of 910.45, followed by a sinking of the senior Average under the 900 level.

INFLATION: In March of this year, the increase in the overall wholesale price index was an unbelievable annualized rate of 27.6%, highest rate since the 1951 Korean War. In April the rate dropped to a still-whopping 12% rate. This "drop-off" stemmed from the decline of the "farm products, feeds and processed foods" rate, which was at a 60% (!) rate in March, at a mere 1.2% rate in April. Meanwhile, prices of consumers' finished goods showed a jump of 1.4% in April or 16.8% on an annualized basis. Finally, McGraw-Hill, in their survey, showed that capital spending is projected to spurt 19% in 1973, to an all-time record high.

The politest way to put it is that inflation is "out of control." The President has done little to halt the fires. Congress is continuing its stance of impotence. It is clearly falling to the Federal Reserve Board to "do something" about the tide of inflation which is now sweeping the nation. One of the best commentaries on the whole picture has come from Money & Credit (1 Battery Plaza, NYC 10004). The following is from their report of May 1:

"A business boom that is racing out of control and a Federal Reserve policy that is becoming increasingly restrictive. If these sound like the ingredients of an economic explosion, you may be sure that that's what they are. It's an irresistable force meeting an immovable object. The shock waves are bound to be felt far and wide.

"Monetary policy is perhaps the most formidable weapon in the Government's arsenal for damping down the boom and beating back inflation. You may be sure that the monetary authorities will make the most of it in coming months. They have to. They have no alternative now that Congress, after threatening to clamp controls on wages and prices, apparently is resigned to letting economic events run their natural course - with blame to be heaped on Mr. Burns and Mr. Nixon if things don't work out.

"Higher interest rates and credit scarcity therefore are in the cards. So far, the monetary authorities have been reluctant to tighten up as much as they would like for fear that Congress, which has more than its share of low interest rate, easy money adovcates, would put a lid on bank rates right across the board.

"The latest hike in the banks' prime rate from 6 1/2% to 6 3/4% and the rise in the discount rate from 5 1/2% to 5 3/4% are straws in the wind. We predict that both rates will move higher as the two-tier concept of the prime is accepted and the Fed feels less restrained by Congress. By late spring, we'd say, you should see the prime well over 7%, with borrowers at the Fed's discount window paying more than 6%."

My peripatetic friend Harry Schultz (the only human being on whom the sun never sets) uses his own brand of strong language to describe the situation (from his end-of-April report): "The overall US inflation rate, on a practical level, is probably now 17%, highest in the Western World. This is brutal destruction of capital. Latin America now extends clear up to the Canadian Border."

MONETARY INDICATORS: Lined up on this page are the four indicators with which I seek to measure the monetary underpinnings of Wall Street. The D-J Utility Average and the D-J 40-Bond Average are used together as a kind of "combination monetary barometer." Anytime these two Averages are in an uptrend, the monetary climate can be said to be favorable, since both indices are extremely sensitive to impending changes in interest rates. Conversely, anytime the two Averages are declining, the monetary climate for the stock market can be considered negative or deteriorating.

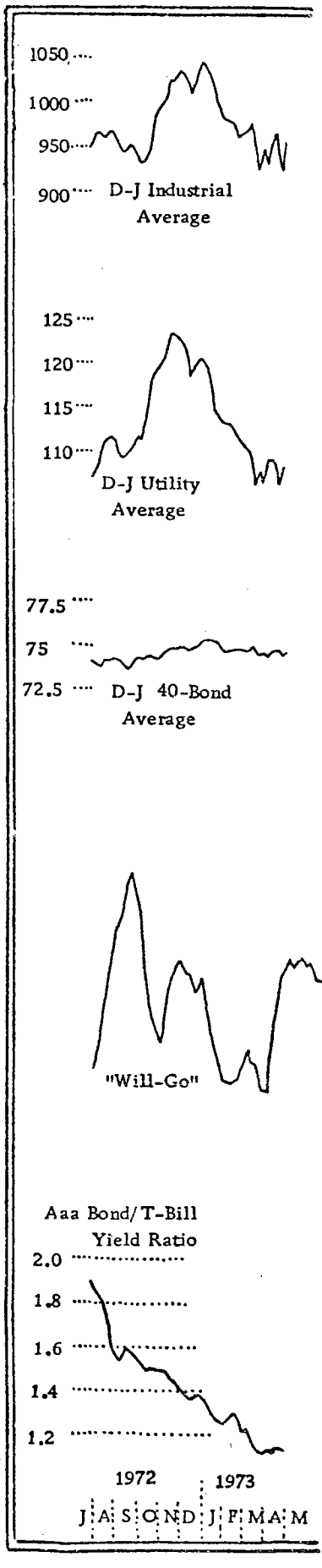
The Utility Average hit its peak during November, 1972, and it has been in a downtrend ever since. The 40-Bond Average recorded a high in January, 1973, and although the movement since then has been minimal, the 40-Bond Average is nevertheless in a shallow downtrend. Therefore, the Bond-Utility syndrome must be rated bearish at present.

"Will-Go" (as I have stated in previous Letters) has been calling for a market rally to begin the first week in April. Actually, the rally began on March 26, which should be accurate enough for anyone but a perfectionist. So far, Will-Go indicates that the rally will peak around the end of May. Last week Will-Go completed a decisive downward zig-zag, as shown on the chart. This suggests trouble by no later than mid-July with June being a month of downward drift.

Will-Go is computed on the basis of yield differential between Barron's High-Grade bonds and the D-J Industrials (as shown in Barron's). The figure is plotted with a ten-week lead time. I will not again go into the formula for arriving at Will-Go, but readers will be kept abreast of new developments in this extraordinary little forecasting indicator.

Finally, the ratio of the yields for Aaa Industrial bonds and the yields on 91-day Treasury bills, having dropped under the bearish 1.20 level, is still in highly negative territory. A preliminary bullish signal would be given on a rise in this indicator above 1.20, and a strong bull signal would be forthcoming on a further rise above 1.45. At present, this ratio is at 1.16.

Conclusion: Three of the four monetary indicators are now bearish. Will-Go is bullish into June, and more time will be needed for a further "forecast" on Will-Go. Remember, Will-Go never "predicts" extent of a movement, only direction and timing.



U.S. Purchases $9 Million in Russian Gold

Exclusive to The Times from Reuters

WASHINGTON — The United States imported 113,757 ounces of Soviet gold in March worth $9,488,472, the Commerce Department reported Friday.

This means U.S. importers paid an average of $83.40 an ounce during the month compared with February's average cost of $67.78 an ounce on imports totalling 89.128 ounces.

Soviet gold sales resumed to the United States in May last year following agreement on massive purchases of grains and other commodities from America.

Since that time the United States has imported a total of 759,491 ounces of gold valued at nearly $52 million. Imports this year have so far totalled 225,000 ounces valued at $17 million.

GOLD: The Government is either kidding us about the value of gold, or lying to us. On the one hand they have announced that an ounce of gold is worth only $42.22 (by the terms of the latest devaluation). Furthermore, the Government tells us that gold is a "barbarous relic" and should be phased out. Well, if that's true, why is the US taking in Russian gold? And as if that isn't hypocritical enough, why is the US paying $83.40 an ounce for it?

You say you don't believe it? The article at left states that during March, the US purchased 113,000 ounces of Russian gold ($9 million worth) at $83.40 an ounce. And this, of all things, comes following February purchases of Russian gold of

89 million ounces at an average price of $67.78 per ounce!

Now my theory isn't really very brilliant. My theory is that we are seeing part of the terms of the US wheat sales to Russia being carried out. The agreement (the actual terms are still secret) probably stated that a certain amount of the wheat was to be paid for in Russian gold at the free market price. Thus, we see the pathetic spectacle of the US, having lost most of its gold (having sold it) at the old price of $35, now taking in Russian gold (and as much as we can get of it) at the free market price!

My guess is that only a small part of the Russian payments for the huge US wheat purchases will be in gold. The rest could be in some form of exchange, for instance, gas or oil at a later date. No one yet knows the terms of the agreements. Nevertheless, a few things are clear.

1. Russia is the second largest producer of gold, second only to South Africa.
2. Russia would like a sky-high price for gold, since she is such a big gold producer.
3. Russia has huge proven oil reserves, around 75 billion barrels. She therefore does not need mid-Eastern oil. But she would most definitely like to control mid-Eastern oil. And Russia would most definitely like to be able to have the power to withhold Arab oil from the US, Europe and Japan. The Russian Navy and the Russian supplies of arms to the Arabs both point to the Russian interest in "controlling" Arab oil and oil-politics.
4. One of the "deals" that Russia could make with the US, assuming she can influence Arab oil and politics, is a sky-high price for gold. Europe would quickly go along with such a deal, since Europe has a large supply of gold now. Japan would go along with such a policy, and the Japanese Government's new policy of legalizing gold for its citizens would seem to be a method for building up gold stocks in Japan — and fast.
5. Obviously, the US "energy crisis" and gold politics go together. As I see it, all force militates towards an ultimate very high price for gold. Meanwhile, the US continues its idiotic policy of "fixing" official gold at $42 while trading its assets (wheat) for gold at the free market price which is around $90. The US should follow Japan's example and allow legalization of gold here (which would bring in huge gold buying by American citizens, thus boosting gold imports to this nation as well as stimulating gold mining activities here). At the same time, the US should make the dollar convertible into gold at some very high price, so high that gold speculation would be ended for years to come. Finally, the US should do whatever is necessary to become competitive in world markets. This could mean deflation, but ultimately deflation will arrive anyway.

A few comments about the price of gold. It is worth noting that the London free market price for gold has held above $90 for a record three weeks running. My own "theory" is that large interests (probably the dollar-glutted Arabs) have placed standing orders for all the gold available at or near $90. They are not yet aggressive buyers, but they will take all the gold being offered around $90. When the $90 gold is off the market, the price of gold will move up to and over $100.

No sooner was this written than on May 8, the second London gold fixing jumped to $91.40, a new record for this "official" price. In my personal opinion, when and as spot gold moves over the "magic $100" price, this should have an electrifying effect on the public. Such a move (over the $100 resistance) allows for a new major rise towards the $150 mark.

Another interesting facet: As seen in this news clip from the Nevada State Journal, gold futures for the first time have risen over $100. Thus, gold has sold above the "magic $100" price for the first time in history (probably a sneak preview of things to come).

Special to The Globe and Mail

WINNIPEG — Gold for April, 1974, delivery has reached an unprecedented price of $100 an ounce during futures trading on the Winnipeg Commodity Exchange.

R. P. Purves, chairman of the exchange's gold committee, said in an interview he believes this is the first time that gold has sold for as much as $100 an ounce on any recognized bullion market. He also said the attainment of the price represents a milestone for the fledgling Winnipeg gold futures market, established last November.

Exchange officials had been waiting for more than a week for the price breakthrough on April, 1974, contracts. Of late, international buyers have been displaying keen interest in gold because of a general lack of confidence in the value of world currencies.

Mr. Purves, in fact, was the trader who bought the first $100 an ounce contract on behalf of his client, Pope and Co., a Toronto brokerage firm. This set the trend for a steadily rising market and, by the close, gold for April, 1974,

COMMENTS: Over the past few months I have gathered an extraordinary number of new readers, and obviously these new readers do not know much about me or the way I work. I'll just say one thing here, and that is that I do not run Dow Theory Letters as a "popularity contest." If I think something and it isn't pleasant I still feel it is my duty to say it, regardless of subject. So here goes:

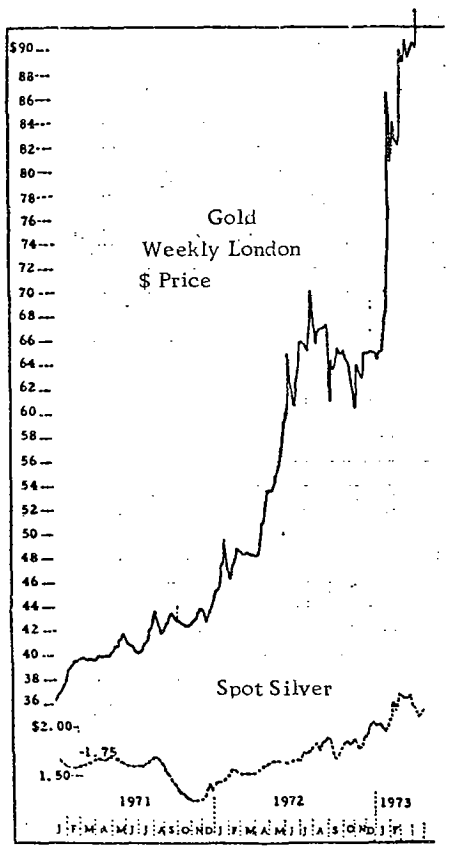
1. Watergate has badly damaged President Nixon's credibility, at a most unfortunate time in history. The odds are heavily against the President's resignation or impeachment, but if the evidence is there and it is damning enough, anything could happen. Personally, I find it interesting that this Administration, which has attacked the free press so relentlessly, should ultimately be pulverized by the free press. As I have written before, "Whom the gods would destroy, they first make mad."

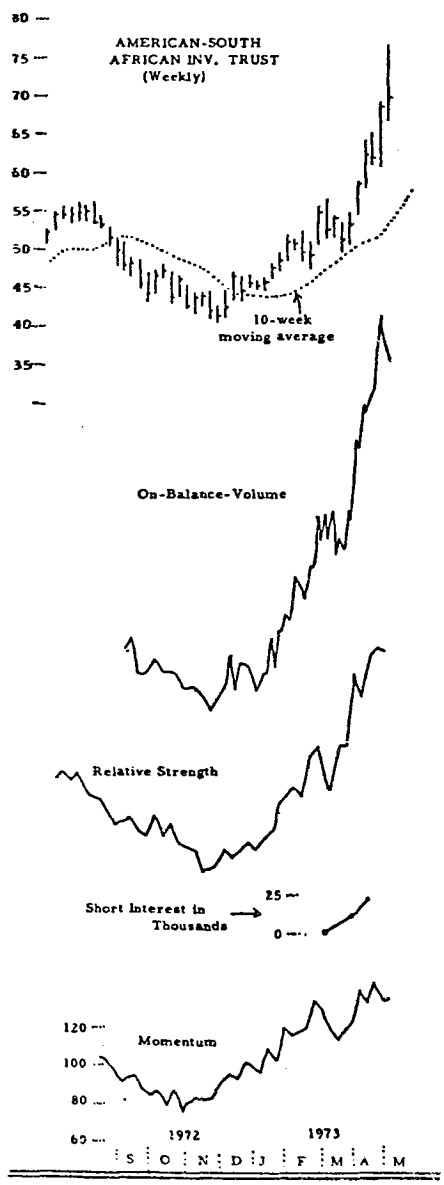
Many say that Watergate should be swept under the rug, that it constitutes an attack on the Presidency itself and on America. I do not subscribe to this. Nixon is not America, he is only a human being in the top office. One might as well say that Christianity was almost destroyed because a disciple, Judas, was a betrayer. If one accepts the thesis that events occur so that man can learn, Watergate takes on real significance, the meaning of which I leave to each individual subscriber.

2. Many outstanding technical (technical, mind you) analysts are now saying that the market cannot go lower "because the fundamentals in the market are too good." Ordinarily, I would not comment on such a simple-minded approach, but as I say, the men who take this position are, in many cases, outstanding. Let me wearily repeat what I learned decades ago when I first became interested in the technical approach. "What people know today ceases to be a factor in the market. The market's function is to look ahead, to discount, to reflect conditions as they will be six months or a year ahead." New readers please study that statement. For ignoring it will cost you your shirt in Wall Street, over and over again!

I will add that many stocks are now considered "cheap" on the basis of their price/earnings ratios. This yardstick is so widely followed that P/E ratios on each stock have been included along with stock quotes in leading daily newspapers. In other words, everyone is now looking at the same things and thinking the same things. And when everyone thinks the same, no one is thinking. Thought: Liquidity and relative yields of stocks (vs. relative yields of other investments) will be the criterion in the months ahead. The last thing that interests me now is stock P/E's, because it is every bull's argument for "why stocks cannot go much lower."

STOCKS AND ITEMS: May 9, London gold at new all-time high of $92.75, as seen on the accompanying chart. I include one of my own technical charts of American-South African, the NYSE-listed gold trust. Note that everything is in gear on the upside. Note the new addition, the short-interest which moved up from a March total of 11,000 in ASA to 14,000 in April. When the shorts start building up against a primary bull movement, watch out. The end result is an explosive rise. The OBV on this chart has been an excellent indicator, it being the net daily additions (or subtractions) of trading volume.





On my technical studies of the 30 Dow stocks, the latest week provides a total technical point total of 42 out of a possible peak score of 150. The low for the year was 29, hit in April, but the 42 total will have to show plenty of steady building to indicate that the Dow is heading substantially higher. Currently, the strongest Dow stock is AT & T, the only stock rated 4. Next strongest (all rated 3) are Alcoa, Bethlehem, DuPont, US Steel.

BUNNY HOP? For some unconscious reason, I often fasten on to a certain stock and watch it for months. I chose newly-listed Playboy in 1971, because it was so "glamourous" and so obviously successful. But the fundamentals proved a terrible trap. As seen on this little chart (courtesy of Quote, PO Box 213, Wichita, KS 67201), PLA has collapsed, losing 2/3rds of its value since the high of 25. What's wrong? Damned if I know. Reminds me of the time years ago when I asked an ancient Wall Streeter why a certain stock had gone down. He looked at me for a few pitying seconds and said, "More sellers than buyers, sonny."